

WATER/FLC:jrb

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION

RESOLUTION NO. W-4534

May 5, 2005

R E S O L U T I O N

**(RES. W-4534), GREAT OAKS WATER COMPANY. ORDER
APPROVING ADVICE LETTER NO. 169-W.**

SUMMARY

This Resolution approves Great Oaks Water Company's (Great Oaks or Company) Advice Letter Number (AL No.) 169-W for a Litigation Expense Memorandum Account for the reasons shown.

BACKGROUND

Great Oaks filed AL No. 165 on December 13, 2004, to establish five memorandum accounts using the procedure described in the Water Division's Standard Practice U-27-W (Standard Practice or U-27-W). The U-27-W procedure requires water utilities to file in the "Preliminary Statement" part of the tariffs new tariff sheets with descriptions of the memo accounts. This is the method for establishing memo accounts used by energy and telecommunications utilities. Great Oaks requested five separate memorandum accounts including the following litigation expense memorandum account:

"A Santa Clara Valley Water District Memorandum Account to track litigation costs incurred to stop the Santa Clara Valley Water District from discriminating against the Company and its ratepayers in how it charges for water pumped from the ground as opposed to treated surface water,"

On December 29, 2004, the Office of Ratepayer Advocates (ORA) filed a protest to AL No. 165. ORA cited the provisions of Decision (D.) 02-08-054 wherein the Commission laid out four guidelines for the establishment of memo accounts:

1. The expense is caused by an event of an exceptional nature that is not under the utility's control;
2. The expense cannot have been reasonably foreseen in the utility's last General Rate Case (GRC) and will occur before the utility's next scheduled rate case;
3. The expense is of a substantial nature in the amount of money involved; and
4. The ratepayers will benefit by the memorandum account treatment adopted.¹

Water Division subsequently wrote Resolution Number (Res. No.) 4525 recommending rejection of AL No. 165. Great Oaks subsequently withdrew the advice letter.

On April 8, 2005, Great Oaks filed AL No. 169-W to add a new section to the preliminary statement in its tariffs to establish a memorandum account. The purpose of the account was to track the expenses of a lawsuit against the Santa Clara Valley Water District (District) to stop its practice of levying a "northern zone" pump tax upon the utility that is then passed through to utility customers through a balancing-type memorandum account. The suit would also request correction of misallocations between the water utility and flood control function managed by the District which causes pump tax to be increased more than otherwise necessary, and a refund of monies already overpaid to the extent permitted by the statutes of limitations. Great Oaks states that, if the litigation is

¹ D.02-08-054, August 22, 2002, "Interim Decision Authorizing the Creation of a Memorandum Account," in Application 01-09-062 et seq. *In the Matter of the Application of California Water Service Company (U 60 W), a Corporation, for an Order Authorizing It to Increase Rates Charged for Water Service at Each of Its Operating Districts to Recover Increased Operating Expenditures at Its General Office*, at 3.

successful, the ratepayers would save more than \$5,131,344 per year in pump tax, or about \$5.00 per customer per week.

However, unlike the Commission's usual practice of not passing through litigation costs if the utility loses the lawsuit, this memorandum account provides that, in the event the utility loses the suit, the ratepayers would pick-up up to \$100,000 of the legal costs (about \$5.00 per customer). That is the reason Water Division believes that a resolution is required.

DISCUSSION

In order for a regulated water utility to establish a memorandum account it must address the four criteria outlined above. In this filing the utility did so as follows:

“a. The Company has no control over the amount of pump tax imposed by this special governmental unit, and until the Fall of 2004 was unaware of the solid basis to challenge how the tax imposed.

“The Santa Clara Valley Water District is a countywide special district established by the California Legislature. The SCVWD is a dual agency that manages both the water resource and flood control throughout Santa Clara County. The SCVWD funds the water resource from pump tax on the water the Company draws from the ground and serves to its customers, and to a limited extent property tax. The pump tax is a pass through expense to the Company and is essentially paid 100% by customers. Total pump tax paid by the Company and customers in 2004 was \$5,131,344, or about \$100,000 a week or \$5 a customer a week.

“The SCVWD has divided the county into two pump tax zones North County and South County. The North County rate is about two times the South County rate. The essential SCVWD rationale for this distinction is that the North County zone has the facilities to create and use treated water, but treated water is not available to the South County zone.

“Great Oaks service territory bridges both zones. The Company has never connected to or used the treated water provided by the SCVWD. In fact, it is the often expressed desire of our customers that the Company never do so, because the Company's untreated ground water tastes much better, and has no treatment

byproducts. All other retail water providers in the north zone either use or are connected to the SCVWD treated water facilities.

“Despite this clear distinction the SCVWD has included most of Great Oaks wells and territory in the north zone. This means customers are currently paying much more for water than if the Company was fully included within the south zone. In addition to the forward looking savings, there is also the clear opportunity for rebate of the excess pump tax collected for the time allowed by the applicable statutes of limitation.

“The Company also believes that the SCVWD has inappropriately charged the water utility with part of the expenses that should be allocated to flood control in violation of the SCVWD’s enabling act. The impact of this misallocation is to increase the pump tax on water in both zones. In addition to the forward looking savings from proper allocations, there is also the clear opportunity for rebate of the misallocations for the time allowed by the applicable statutes of limitation.

“The legal basis for challenging both issues was not known to the Company before the Fall of 2004.

“b. The expense cannot have been reasonably foreseen in the utility’s last general rate case and will occur before the utility’s next scheduled rate case.

“The litigation and Memorandum Account were not contemplated in the Company’s last rate case order D.0312039 mailed December 19, 2003. The reason is that the Company did not learn of the basis to challenge how the pump tax is imposed until the Fall of 2004. Additionally, the Company did not learn of the misallocations until after that time. Time is of the essence, because every day that passes without the lawsuit filed means the Statute of Limitations eliminates another day of potential refund or rebate of tax paid or misallocated.

“c. The expense is of a substantial nature in the amount of money involved.

“As stated above, total pump tax paid by the Company and customers in 2004 was \$5,131,344, or about \$100,000 a week or \$5 a week per customer. If the litigation is successful the Company believes it will reduce this pass through expense by 50% or \$125 per customer a year or \$2.50 a week in current dollars and pump tax.

“d. The ratepayers will benefit by the memorandum account treatment.

“Because pump tax is a pass through expense, the Company’s view is any money recovered should belong to the ratepayers.

“The Company had requested this result in the context of Advice Letter 165 filed December 13, 2004, i.e. that ratepayers take the risk of the suit and obtain 100% of the benefit. The Company sought no reward, only to be protected from the cost of the litigation which only benefits ratepayers. However, in that filing the Company did not suggest any limit on the cost of the litigation that could accrue in the Memorandum Account.

“In the context of AL 165 ORA advised it was concerned about the potential cost and preferred the Company bear the risk of the litigation, and that after attorneys fees and costs were repaid would recommend 30% of the net proceeds go to the shareholders as a reward for taking the risk.

“AL 165 was withdrawn by the Company on February 23, 2005 because it included other matters not related to the SCVWD, which did not provide for a focused discussion on just the Water District.

“The Company has carefully considered ORA’s suggestions from AL 165.

“The Company has proactively responded to ORA’s comments by adding a cap on the proposed Memorandum Account, capping potential ratepayer risk for litigation expenses to \$100,000. This means for the risk equal to the cost of one week of pump tax the ratepayers will have the opportunity to have the tax they pay cut in half, which could mean a reduction of over \$2.5 million out of \$5 million annually in current dollars and tax. Despite the reward suggested by ORA, the Company believes that pass through expenses should be at the ratepayers’ risk and the potential reward to ratepayers is worth the minimal risk equaling one week’s additional tax.

“If the litigation is successful, then the expense of the litigation will first be charged against that recovery to the extent permitted by law, with only net cost remaining, if any, requested for recovery from ratepayers through the Memorandum Account.

“The Company requests that AL 169-W be allowed to go into effect or affirmatively authorized by the Commission. If allowed to go into effect or affirmatively authorized, the Company recognizes that no expenses can be converted from the Memorandum Account into rates without further Commission review and action.

“The tariffs also provide the accounting procedure from Standard Practice U-27-W, including the fact that only funds incremental to or additional to those authorized in the Company’s last rate case can be included.”

In its prior evaluation of this memorandum account when it was filed in AL No. 165, the Water Division said:

“The Santa Clara Valley Water District Memorandum Account seems to be a litigation memorandum account. The pursuit of this litigation would hopefully result in a readjustment by the Santa Clara Valley Water District (District) in how it covers its costs, shifting more costs to surface water customers and lowering the costs to Great Oaks and other groundwater customers. Great Oaks estimates savings of as much as \$2,500,000. While this may be a worthy endeavor, it needs to be discussed in the GRC. If there are going to be cost savings, this Commission should decide how they should be allocated. Also, lowering Great Oaks’ cost might result in raising other utility’s costs. For example, San Jose Water Company’s customers’ costs may increase since San Jose buys treated surface water from the District. Consideration of these and any other consequences is best addressed in a GRC.”

Since that time the Company has provided more information. It has contacted an outside law firm that believes the suit will be won, and that has committed to its costs being \$100,000 or less. (The only situation in which the Company thinks the cost may exceed \$100,000 would be if the Company has to do an audit. In that case the Company would recover those costs from the award if they win the suit, or would absorb them if it loses.)

With respect to San Jose Water Company’s customers seeing an upward pressure on their bills, the Water Division admits that it would not be nearly as large as the drop in Great Oak’s customer’s bills since it would be spread over a substantially larger customer base.

Normally, when a utility litigates, it would hope to get an award that gives it some monies over its costs. Great Oaks has chosen not to pursue the lawsuit independently, where, if it won, it could bank the lower costs until its next general rate case. Instead it will immediately lower rates and surcredit any dollars received for past overpayments. This may constitute some basis for having the customers pick up the first \$100,000 or litigation costs if the Company loses.

Water Division understands Great Oak's urgency to go forward with the litigation considering the substantial costs which could be saved. Additionally the utility has coordinated with the ORA. ORA did not protest this advice letter. Consequently, and because spreading of the \$100,000 across Great Oak's approximately 20,000 service connections could be considered *de minimus*, Water Division recommends the Commission approve the memorandum account.

NOTICE AND PROTESTS

Because the AL requested no rate changes, no public notice was required. The AL was sent to the standard service list.

COMMENTS

This is an uncontested matter subject to the public notice comment exclusion provided in Public Utilities Code Section 311(g)(3). Comment was received from the ORA that the granting of this memorandum account shall not set precedent for the treatment of legal expenses incurred in the normal business operations of the Company.

FINDINGS

1. The Commission has promulgated four guidelines for the establishment of memorandum accounts during the General Rate Case cycle.
2. Great Oaks has adequately addressed those four guidelines in its Advice Letter Number 169-W.
3. Great Oaks is scheduled to file a General Rate Case in July of 2005.
4. The Santa Clara Valley Water District Memorandum Account could have substantial ratepayer benefits. Those benefits would be more substantial if the lawsuit were started as soon as possible.

5. The lawsuit does not raise any known critical issues that would require that it be analyzed in a General Rate Proceeding.

THEREFORE IT IS ORDERED THAT:

1. Great Oaks Water Company's Advice Letter No. 169-W is approved.
2. This memorandum account shall not set precedent for the treatment of legal expenses incurred in the normal business operations of a water utility.
3. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on May 5, 2005; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
DIAN M. GRUENEICH
Commissioners

I abstain.

/s/ JOHN A. BOHN
Commissioner